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ROUTING SLIP

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		ACTION	INFO	DATE	INITIAL
1	DCI		X		
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9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/OLL				
14	D/PAO				
15	D/PERS				
16	VC/NIC				
17	NIO/ECON	X			
18	ES		X		
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SUSPENSE 3 Dec 85
Date

Remarks

The on-again/off-again NSC meeting on S-812 is back on for 3 Dec. This time as a joint NSC-EPC meeting.

[redacted] 25X1

Executive Secretary

2 Dec. 85
Date

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Executive Registry
85-~~4263/5~~ 4751

NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

SECRET

November 29, 1985

MEMORANDUM FOR

Mr. Donald Gregg
Assistant to the Vice President
for National Security Affairs

Mr. Nicholas Platt
Executive Secretary
Department of State

Sherrie Cooksey
Executive Secretary
Department of the Treasury

Colonel David R. Brown
Executive Secretary
Department of Defense

Mr. Stephen Galebach
Senior Special Assistant to the
Attorney General
Department of Justice

Mrs. Helen Robbins
Executive Assistant to the
Secretary
Department of Commerce

25X1

Executive Secretary
Central Intelligence Agency

Mr. Alton Keel
Associate Director for National
Security and International
Affairs
Office of Management and Budget

Mr. Alfred H. Kingon
Cabinet Secretary

BG George Joulwan
Executive Assistant to the
Chairman
Joint Chiefs of Staff

SUBJECT: Joint National Security Council/Economic Policy Council Meeting on Enrolled Bill S. 812 (S)

A National Security Council meeting has been scheduled for Tuesday, December 3, 1985, in the Cabinet Room to discuss Enrolled Bill S. 812. The agenda for the meeting is attached. This meeting is being jointly hosted with the Economic Policy Council. (S)

William F. Martin

William F. Martin
Executive Secretary

Attachments

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JOINT NATIONAL SECURITY COUNCIL/
ECONOMIC POLICY COUNCIL MEETING
Tuesday, December 3, 1985
Cabinet Room
2:00 p.m. - 3:00 p.m.

ENROLLED BILL S. 812

Agenda

I.	Introduction -- Background -- Issues for Decision	Robert C. McFarlane (5 minutes)
II.	Political Overview (Need for Additional Authority)	Secretary Shultz (5 minutes)
III.	Strategic Implications	Secretary Weinberger (5 minutes)
IV.	Financial Considerations	Secretary Baker (5 minutes)
V.	Status of IEEPA Authority	Attorney General Meese (5 minutes)
VI.	Soviet Bloc Dependence on the West	Director Casey (5 minutes)
VI.	Discussion	All participants (25 minutes)
VII.	Summary	Robert C. McFarlane (5 minutes)

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THE WHITE HOUSE

WASHINGTON

November 29, 1985

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MEMORANDUM FOR THE PRESIDENT

FROM: THE NATIONAL SECURITY COUNCIL AND THE ECONOMIC POLICY COUNCIL

SUBJECT: Financial Export Control Legislation

ISSUE

Should the Administration support S. 812, which would provide the President discretionary authority to monitor, and if necessary, restrict U.S. capital flows to the Soviet Bloc in non-emergency cases?

BACKGROUND

In March 1985, Senators Garn and Proxmire introduced S. 812, the "Financial Export Control Act," which would amend the Export Administration Act (EAA) to authorize the President to "prohibit, curtail, monitor, or otherwise regulate the export" of U.S. capital "to the government of any controlled country," which in practice would mean countries in the Soviet Bloc. The EAA now provides authority to control exports of goods and technology to the Soviet Bloc and other destinations.

Supporters of S. 812 argue, *inter alia*, that U.S. bank lending helps the Soviet Bloc import Western technology and finance activities that damage U.S. national security. The Department of Defense (DOD) cites as an example the timing of U.S. loans to East Germany with the announcement of an East German loan to Nicaragua.

The International Emergency Economic Powers Act (IEEPA) currently grants the President authority to restrict U.S. capital flows to the Soviet Bloc only in cases of emergencies threatening the national security, foreign policy, or economy of the United States. S. 812 is designed primarily to provide the President discretionary authority to restrict such flows in cases of non-emergencies as well. In addition, S. 812, read in conjunction with the Export Administration Act, could provide the President discretionary authority to restrict such flows to nations that support international terrorism or threaten regional stability.

The Senate Banking Committee is scheduled on December 4 to hold a second hearing on S. 812 and has invited the Departments of the Treasury and Defense to testify on the proposed legislation.

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POLICY OBJECTIVES

The Administration should consider this issue in the context of its impact on our national security, allied relations, and economic competitiveness. S. 812 would not require the restriction of U.S. bank lending to the Soviet Bloc. It would only provide the President discretionary authority to restrict such flows. However, one should evaluate S. 812 in terms of how actually using that discretionary authority to restrict such lending would affect our national security, allied relations, and economic competitiveness, particularly since the legislation would provide such authority to future administrations.

National security. How would restricting U.S. bank lending to the Soviet Bloc affect U.S. national security? The ability of the Soviet Bloc to generate hard currency through either exporting products or taking out loans enhances its ability to purchase both legal and illegal Western technology, which may damage U.S. national security and force the U.S. to devote more economic and budget resources to maintaining our technological lead. In addition, S. 812 supporters argue that increased U.S. bank lending to the Soviet Bloc has helped it finance activities in Central America and elsewhere that damage U.S. national security.

The Department of Defense argues that restricting U.S. bank lending to the Soviet Bloc would reduce its ability to obtain hard currency and thus purchase Western technology. S. 812 opponents argue that without the cooperation of our allies to restrict their lending, unilaterally restricting U.S. bank lending to the Soviet Bloc would probably not reduce the ability of the Soviet Bloc nations to obtain hard currency because other lenders would displace U.S. banks.

S. 812 opponents argue that continuing to focus our efforts on COCOM would be more productive than restricting U.S. bank lending in reducing the ability of the Soviet Bloc to purchase vital Western technology. S. 812 supporters suggest that the legislation would supplement COCOM by enabling the President to restrict the hard currency financing of activities, such as insurrections, as well as the financing of goods and technology covered by COCOM.

NSDDs 66, 75 and 169 define the linkage between commercial, foreign policy, and national security policies in U.S.-Soviet relations (see appendix). The Department of State believes that one element of a constructive relationship with the Soviet Union must be mutually beneficial nonstrategic trade. S. 812 might have an adverse effect on our efforts to encourage such trade and might be perceived as an attempt to engage in economic warfare, a policy which has been disavowed by this Administration. In addition, S. 812 might create confusion among our allies concerning the Administration's policy toward the Soviet Union and send signals that run directly counter to the message you created in Geneva.

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Relations with our allies. How would attempting to restrict U.S. bank lending to the Soviet Bloc affect relations with our allies? In order to meet the stated objective of S. 812 to reduce "the ability of [Soviet Bloc] countries to obtain sensitive goods and technology," the total flow of hard currency from either Western loans to or imports from the Soviet Bloc would have to be restricted.

Any restriction of the total flow of hard currency to the Soviet Bloc would require the cooperation of foreign governments to lend less to the Soviet Bloc and not offset that reduced flow by importing more from the Soviet Bloc. Yet, our COCOM allies and other cooperating countries may resist further U.S. efforts to persuade them to restrict lending to the Soviet Bloc. For example, a determined effort in 1982 to persuade our major allies to agree to restrict official credits to the Soviet Bloc was less than fully successful.

Simply attempting to restrict the total flow of hard currency to the Soviet Bloc raises two risks to relations with our allies:

- o Given the need to obtain the cooperation of foreign governments to restrict effectively the total flow of hard currency to the Soviet Bloc, attempting to restrict such flows could strain relations with our allies, particularly West European countries.

- o Attempting to restrict the flow of U.S. bank lending from not only domestic banking offices, but also overseas branches and subsidiaries of U.S. banks, would raise the sensitive issue of extraterritoriality and would provoke strong European reaction similar to that resulting from the 1982 pipeline dispute. Very little current U.S. bank lending to the Soviet Bloc is done from domestic U.S. offices.

S. 812 opponents argue that even a reduction of the total flow of hard currency to the Soviet Bloc may not deter those countries from importing Western technology because they could reallocate hard currency from other uses, i.e., there would be some reduction of total imports, but not necessarily of vital technology. S. 812 supporters argue that reducing the total flow of hard currency to the Soviet Bloc by even a small amount could reduce its ability to import Western technology by requiring it to make more difficult choices between competing demands.

Economic competitiveness. How would attempting to restrict the flow of U.S. bank lending to the Soviet Bloc affect U.S. economic interests? There are at least two significant economic risks:

- o Without the cooperation of foreign governments to restrict non-U.S. lending to the Soviet Bloc, unilaterally restricting U.S. bank lending to the Soviet Bloc would sharply reduce U.S. exports (including grain) to these countries, which last year totalled $7.2 billion, and might drive business to Western Europe and Japan.

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- o Cumulative restrictions on the outflow of U.S. capital might eventually lead to less foreign capital inflow into the U.S. and thus higher U.S. interest rates. Foreign investors find the U.S. financial markets attractive in part because of the absence of any U.S. exchange controls. Foreign investors could infer from legislation restricting U.S. bank lending to the Soviet Bloc a greater willingness by the U.S. to impose financial sanctions against residents of any country with which the U.S. differed. Such a perception might decrease the foreign demand for U.S. assets and raise U.S. interest rates.

POLICY OPTIONS

The Administration faces the issue of whether to support legislation providing the President discretionary authority to restrict U.S. capital flows to the Soviet Bloc in non-emergency cases. Because the IEEPA grants the President authority to restrict such flows only in emergency cases, a decision to support such legislation would suggest supporting S. 812 or working with its supporters to fashion an acceptable legislative alternative.

You should note that the December 3 NSC/EPC meeting represents the first NSC or EPC meeting on this issue. DOD strongly believes that you should have the benefit of hearing a discussion of this issue at a Cabinet level before making a decision.

Option 1: Support S. 812 or an acceptable legislative alternative, which would provide the President discretionary authority to restrict U.S. capital flows to the Soviet Bloc in non-emergency cases.

Advantages

- o If such a policy succeeded in restricting the flow of total, not just U.S., capital to the Soviet Bloc, it could increase the economic costs to the Soviet Bloc of importing Western technology.

- o Closer linkage between all aspects of foreign policy--diplomatic, commercial, and national security--would be assured. The security-minded objectives outlined in NSDDs 66, 75, and 169 would remain our policy.

- o Credit sanctions against adversaries in non-emergency situations give the President greater latitude in responding to foreign policy challenges.

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- o It could be useful to have authority to restrict U.S. capital flows in non-emergency cases, for example, where other countries support international terrorism or threaten regional stability. The Department of Justice suggests that supplementing the President's statutory authority with the authority provided by S. 812 would obviate the need to invoke IEEPA (with its notification requirements) in non-emergency cases.

Option 2: Oppose S. 812 and continue the current policy of not restricting arms-length non-concessional business, including U.S. bank lending to the Soviet Bloc.

Advantages

- o Supporting legislation that provides the President discretionary authority to restrict U.S. capital flows to the Soviet Bloc in non-emergency cases contradicts, particularly in the aftermath of the Reagan-Gorbachev summit, the President's policy of improving our dialogue with the Soviet Union and its allies. Part of this effort is to support the development of mutually beneficial nonstrategic trade.

- o If a President used the discretionary authority under S. 812 to restrict in non-emergency cases the flow of lending of U.S. banks, particularly that from overseas branches and subsidiaries, to the Soviet Bloc, it would probably strain relations with our allies, particularly West European countries.

- o Restricting the flow of U.S. bank lending *per se* to the Soviet Bloc could be ineffective because such lending could be displaced by lending from non-U.S. financial institutions. Moreover, even a reduction of the total flow of hard currency to the Soviet Bloc may not deter those countries from importing Western technology because they arguably could reallocate some foreign exchange from other uses, i.e., there would be some reduction of total imports, but not necessarily of vital technology.

- o Not restricting U.S. bank lending to the Soviet Bloc would support the competitiveness of U.S. firms selling non-strategic products to the Soviet Bloc.

- o Maintaining the confidence of foreign investors that the U.S. financial markets will remain open maintains the attractiveness of investing in U.S. assets and thus avoids raising U.S. interest rates.

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Option 3: Indicate to Congressional supporters of S. 812 that the Administration opposes any legislation that would provide the President discretionary authority to restrict U.S. capital flows to the Soviet Bloc in non-emergency cases, but note that the Administration will continue to assess the implications of uncontrolled financial flows to the Soviet Bloc and the feasibility of any policy proposals.

Advantages

- Provides the same advantages as Option 2, but also expresses to Congressional supporters of S. 812 that the Administration continues to recognize the need to reduce the ability of the Soviet Bloc to import strategic Western technology.

DECISION

_______ Option 1: Support S. 812 or an acceptable legislative alternative, which would provide the President discretionary authority to restrict U.S. capital flows to the Soviet Bloc in non-emergency cases.

_______ Option 2: Oppose S. 812 and continue the current policy of not restricting arms-length non-concessional business, including U.S. bank lending to the Soviet Bloc.

_______ Option 3: Indicate to Congressional supporters of S. 812 that the Administration opposes any legislation that would provide the President discretionary authority to restrict U.S. capital flows to the Soviet Bloc in non-emergency cases, but note that the Administration will continue to assess the implications of uncontrolled financial flows to the Soviet Bloc and the feasibility of any policy proposals.

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Appendix

Review of Past Presidential Policy

The latest statement regarding U.S.-Soviet commercial relations is contained in NSDD 169, "U.S.-USSR Joint Commercial Commission (JCC) Meetings" (May 17, 1985):

> "...The JCC meetings should be used to continue to express our serious concerns about Soviet human rights abuses and emigration policy. We must make it clear to the Soviets that their continued poor performance in these areas will have a serious negative effect on any effort to establish a more constructive bilateral relationship, <u>including our economic and commercial relations</u>."

Earlier, NSDD 75 on "U.S. Relations with the USSR" (January 17, 1983) specifically addressed commercial and financial issues:

"Economic Policy. U.S. policy on economic relations with the USSR must serve strategic and foreign policy interests as well as economic interests. In this contest, U.S. objectives are:

-- Above all, to ensure that East-West economic relations do not facilitate the Soviet military buildup.

-- To avoid subsidizing the Soviet economy or unduly easing the burden of Soviet resource allocation decisions, so as not to dilute pressures for structural change in the Soviet system.

-- To seek to minimize the potential for Soviet exercise of leverage on Western countries based on trade, energy supply, and financial relationships.

-- To permit mutually beneficial trade--without Western subsidies or the creation of Western dependence--with the USSR in non-strategic areas, such as grain."

NSDD 66, "East-West Economic Relations and Poland-related Sanctions," (November 29, 1982) defines specific objectives in East-West trade in the areas of credits, energy dependence, and exports of advanced technologies.

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WASHFAX RECEIPT

THE WHITE HOUSE

C

MESSAGE NO. 049 CLASSIFICATION SECRET PAGES 9

FROM WILLIAM F. MARTIN

(NAME) (EXTENSION) (ROOM NUMBER)

MESSAGE DESCRIPTION JOINT NATL SECURITY COUNCIL / ECONOMIC POLICY COUNCIL MTG 3 DEC RE S-812 LOG #: 91113 redo

TO (AGENCY)	DELIVER TO:	DEPT/ROOM NO.	EXTENSION
STATE	NICHOLAS PLATT	EXEC SEC	
TREASURY	SHERRIE COOKSEY	EXEC SEC	
DEFENSE	DAVID R. BROWN	EXEC SEC	
~~JUSTICE~~	~~STEPHEN GALEBACH~~		
COMMERCE	HELEN ROBBINS		
CIA	[redacted]		25X1
JCS	BG GEORGE JOULWAN		

REMARKS

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THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 11/27/85 **Number:** 317029CA **Due By:** ______

Subject: NSC/EPC Meeting With The President -- December 3, 1985 -- 2:00 P.M. -- Cabinet Room

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☑	☐
Justice	☑	☑
Interior	☐	☐
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☑	☐
Energy	☐	☐
Chief of Staff	☑	☐
Education	☐	☐
OMB	☑	☐
CIA	☑	☑
UN	☐	☐
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
McFarlane	☑	☐
Svahn	☑	☐
Chew *(For WH Staffing)*	☑	☐
Kingon	☐	☑
Hicks	☐	☑
Executive Secretary for:		
DPC	☐	☑
EPC	☑	☐

REMARKS: The President will chair a joint NSC/EPC meeting on Tuesday, December 3, at 2:00 P.M. in the Cabinet Room. The agenda background papers are attached.

RETURN TO:

☑ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☐ Rick Davis
☐ Ed Stucky

Associate Director

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THE WHITE HOUSE

WASHINGTON

November 29, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER EM

SUBJECT: National Security Council/Economic Policy Council Meeting -- December 3, 1985

The agenda and paper for the December 3 meeting of the National Security Council and the Economic Policy Council are attached. The meeting is scheduled for 2:00 p.m. in the Cabinet Room.

The single agenda item will be S. 812, the Financial Export Control Act. A paper reflecting the views of all concerned agencies is attached.

SECRET ATTACHMENT

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THE WHITE HOUSE

WASHINGTON

National Security Council

Economic Policy Council

Tuesday, December 3, 1985

2:00 p.m.

Cabinet Room

AGENDA

1. Financial Export Control Legislation

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